IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: SHIRLEY YARBROUGH and THOMAS YARBROUGH, Debtors. PATRICIA NELSON and JOHNNIE NELSON, Plaintiffs, vs. SHIRLEY YARBROUGH and THOMAS YARBROUGH, Defendants.	Chapter 7 No. 4-05-bk-00816-JMM Adversary No. 4-05-ap-00158-JMM **MEMORANDUM DECISION RE:** **MOTIONS FOR PARTIAL SUMMARY JUDGMENT** (Opinion to Post)

On March 8, 2006, cross-motions for partial summary judgment were filed by both Plaintiffs and Defendants. After considering the facts, law, and arguments of the parties, the court now rules.

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FACTS

The State Court Lawsuit

A. The Complaint

On January 9, 2003, the Nelsons filed a civil complaint against the Yarbroughs, Case No. C20030164. (Ex. A.) The lawsuit primarily concerned the Defendants' alleged trespass upon and interference with the Nelsons' real property, and a related easement. (Ex. A.) The Complaint contained three counts:

Count I	Breach of contract (the warranty deed authorizing use of an easement);
Count II	Intentional Interference with Property Right;
Count III	Injunctive Relief.

The damages sought included compensatory and punitive damages, together with attorneys' fees. The theory for attorneys' fees was expressly provided for in the complaint as ARIZ. REV. STAT. § 12-341.01 (Ex. A), and were sought only in relation to Count I of the Complaint.

A jury trial on all issues was held over a four-day period, from September 21 to 24, 2004. (Ex. 6 and E.)

B. The Jury Instructions and Interrogatories

1. Instructions

The court's instructions to the jury, on the items relevant here, included:

- Several of the instructions related to whether there had been a contract between the parties. (Ex. B.)
- Two instructions related to the claim of interference with property rights. The first read:

> "Each party claims that the other is liable for intentional interference with their property rights. Intentional interference with property rights requires proof that:
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> 1. The interference was substantial;
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> 2. The interference was intentional; and
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> 3. The interference was unreasonable under the circumstances."

The second instruction read:

> 'Intentionally' or 'with the intent to' means that a person's objective is to cause that result or to engage in that conduct.

2. <u>Interrogatories and Jurors' Answers</u>

In addition, the jury responded to relevant factual interrogatories which were posed to them, as follows:

3. Defendants YARBROUGH have obstructed the plaintiffs NELSONS' 30-foot wide easement.

   Answer: Yes.

4. Defendants YARBROUGH have placed the bottom portion of the driveway in the easement.

   Answer: Yes.

(Ex. F and 4.)

3. Verdicts and Judgment

On September 24, 2004, the jury returned a verdict for $3,900 in actual damages in favor of the Nelsons on the intentional interference claims,

> . . . and against defendants YARBROUGH on plaintiffs' claim for Intentional Interference with Property Right based on defendants' removal of safety berms, removal of the Nelsons' survey stakes and pins and/or placing the bottom portion of the driveway in the easement and finding the full amount of damages to be $3,900.00.

(Ex. B, F, 4, 7, and 8.) The jury awarded no punitive or other damages beyond the $3,900 noted above. (Ex. F and 4.) As for the contract count that went to the jury, it returned the following verdict:

> We, the Jury, duly impaneled and sworn in the above-entitled action, upon our oaths, do find in favor of plaintiffs NELSON and against defendants YARBROUGH on plaintiffs' claim for Breach of Contract and find the full amount of damages to be $0.00.

(Ex. B.) (Emphasis supplied.)

The court then instructed Nelsons' counsel to prepare a form of judgment, including a "provision for jury fees" of $860.20. (Ex. F and 4.) On November 19, 2004, judgment was signed by the court for the $3,900 damages amount. The court also, without explanation as to the legal theory utilized, awarded attorneys' fees to Plaintiffs in the sum of $26,765. (Ex. 6 and E.)

LAW

A. General Principles of Collateral Estoppel

If a state court would give preclusive effect to a judgment rendered by another court of that state, then the Full Faith and Credit Act, 28 U.S.C. § 1738, imposes the same obligation upon a federal court. *McDonald v. City of W. Branch*, 466 U.S. 284, 287 (1984). Thus, federal courts must

afford a state court's judgment the same preclusive effect as would occur in that state's courts. *Caldeira v. County of Kauai*, 866 F.2d 1175, 1178 (9th Cir. 1989), *cert. denied*, 493 U.S. 817 (1989).

The bankruptcy court's decision to look to the entire record of the prior proceedings rather than just the judgment is consistent with case law in this circuit. For example, in *In re Houtman*, the Ninth Circuit noted:

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568 F.2d 651 (9th Cir. 1978); s*ee also, In re Daley*, 776 F.2d 834, 836-37 (9th Cir. 1985), *cert. denied*, 476 U.S. 1159 (1986).

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As the Ninth Circuit has noted: "It is not enough that the party introduce the decision of the prior court; rather, the party must introduce a sufficient record of the prior proceeding to enable the trial court to pinpoint the exact issues previously litigated." *United States v. Lasky*, 600 F.2d 765, 769 (9th Cir. 1978), *cert. denied*, 444 U.S. 979 (1979).

In this case, the parties have each moved for partial summary judgment on the § 523(a)(6) issues, and together have provided what they agree is the necessary underlying record. Thus, according to both parties, the matter may be decided on summary judgment as a matter of law. Neither side maintains that issues of fact exist which require a re-trial of the issues.

B. Are Attorneys' Fees of $26,765 Non-Dischargeable?

The largest component of the claim for non-dischargeability is the $26,765 which was awarded for the Nelsons' attorneys' fees.

The Nelsons' complaint (Ex. A) contained a breach of contract count (Count I) for which attorneys' fees may be awarded to the prevailing party if a contested action arises out of an express or implied contract. ARIZ. REV. STAT. § 12-341.01(A). The Nelsons sought fees only under this statute. (Ex. A.) The only other distinct basis, under that statute, by which fees may be awarded is upon a clear and convincing showing "that the claim or defense constitutes harassment, is groundless and is not made in good faith." ARIZ. REV. STAT. § 12-341.01(C). This second ground, however, was neither alleged nor proven by the Nelsons. Thus, it appears that fees were sought only under the contract provision of the statute.

The jury found in favor of the Nelsons on the breach of contract count, although it awarded them no damages. Thus, because the Nelsons prevailed, it was not improper for the court to award attorneys' fees "to the successful party" on that count, even though no damages flowed therefrom. ARIZ. REV. STAT. § 12-341.01 (D) specifically leaves the discretion, to award fees under the statute, to "the Court and not a jury . . . ."

However, from a bankruptcy standpoint, a mere breach of contract claim does not give rise to a non-dischargeable debt under 11 U.S.C. § 523(a)(6). *Snoke v. Riso (In re Riso)*, 978 F.2d 1151, 1154 (9th Cir. 1992). A statutory right to an award of attorneys' fees for a breach of contract does not fit the test for a "wilful and malicious injury." It merely presents a possible monetary consequence for

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The Nelsons also appear to argue that the attorneys' fee award arises out of the intentional tort of interference with a property right, for which they also obtained judgment. However, in Arizona, attorneys' fees for tort actions are not generally allowed.

There is one exception to this general rule. In certain types of contract cases, a successful party on insurance contract "bad faith" claims may recover not only attorneys' fees expended for litigation on the contract claim, but also fees expended in litigating an "interwoven" tort claim. *See Pettay v. Insurance Mktg. Servs., Inc. (West),* 156 Ariz. 365, 368, 752 P.2d 18, 21 (1987); *Campbell v. Westdahl,* 148 Ariz. 432, 440-41, 715 P.2d 288, 296-97 (1985). This exception is narrow, allowing attorneys' fees for "bad faith" denial of contractual insurance claims to be awarded. But these claims are a direct result of a breach of an insurance contract.

In such cases, the injured party usually alleges a combination of tort and contract claims, or merely a tort claim which has as its basis the breach of an insurance contract. Regardless of the form of the pleadings, a court considering that type of a "bad faith" claim will look to the nature of the action and the surrounding circumstances to determine whether the claim is one "arising out of a contract." *Wenk v. Horizon Moving & Storage Co.,* 131 Ariz. 131, 132, 639 P.2d 321, 322 (1982). The leading Arizona case in this area is *Sparks v. Republic National Life Insurance Co.,* 132 Ariz. 529, 647 P.2d 1127 (1982), an insurance bad faith case.

In *Sparks,* the plaintiffs successfully brought an action against their insurer claiming, in part, breach of contract and bad faith (tort). In determining whether the action was one "arising out of a contract" pursuant to § 12-341.01, the Arizona Supreme Court stated that attorneys' fees may be awarded "upon facts which show a breach of contract, the breach of which may also constitute a tort." *Id.* at 543, 647 P.2d at 1141. The fact that the two legal theories are intertwined, it explained, does not preclude recovery of attorneys' fees under § 12-341.01(A) "as long as the cause of action in tort could not exist *but for* the breach of the contract." *Id.*

The basis for this finding is the legal duty, implicit in an insurance contract, that the insurer must deal in good faith with its insured. *Id.* at 543-44, 647 P.2d at 1141-42, quoting *Noble v. National American Life Ins. Co.,* 128 Ariz. 188, 190, 624 P.2d 866, 868 (1981). Because the tort of bad faith was "so intrinsically related to the contract," the Supreme Court held that the insured's action was one "arising out of a contract" within § 12-341. *Sparks v. Republic National Life Insurance Co.,* 132 Ariz. at 544, 647 P.2d at 1142.

The instant case is altogether different from the *Sparks* and *Noble* line of cases. Here, the breach of contract theory was based upon language in a warranty deed, which their predecessor had been a party to, while the tort "interference" theory arose out of a common law set of facts which the Nelsons equate to intentional and tortious acts. The two causes of action were not "interwoven" as are the insurance bad faith cases.[1]

Thus, the only basis for the $26,765 fee award would have been solely for the Nelsons' breach of contract count, which arose out of the warranty deed which granted them an easement.

Since a mere breach of contract claim is dischargeable, and the instant breach of contract was not "interwoven" with a "bad faith" insurance-related tort as Arizona law requires, summary judgment will be granted to Defendants Yarbrough on this aspect of the state court's judgment. The $26,763 of attorneys' fees is thus dischargeable.

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[1] Moreover, it does not appear that Arizona even recognizes a tort of "intentional interference with property rights," and appellate courts have refused to extend the law that far. *See Tobias v. Dailey*, 196 Ariz. 418, 998 P.2d 1091 (Div. 1, Ariz. Ct. App. 1000). Nevertheless, here, the Superior Court allowed the issue to go to the jury, and a judgment was rendered on the claim, which was not appealed. Thus, the parties are bound by the state court decision, and the judgment's preclusive effect may now be determined by the bankruptcy court.

C. **Is the Judgment for Intentional Interference With a Property Right Dischargeable?**

To determine if a state court judgment is non-dischargeable in a bankruptcy case, the bankruptcy court must apply the doctrine of collateral estoppel. Here, the jury awarded damages of $3,900 for the Defendants' intentional interference with the Nelsons' property right.

Although principles of *res judicata* do not apply to dischargeability issues, *Brown v. Felsen,* 442 U.S. 127, 138-39, 99 S.Ct. 2205, 2212-13 (1979), principles of collateral estoppel do. *Brown, id., Grogan v. Garner,* 498 U.S. 279, 284, 111 S.Ct. 654 (1991).

Under bankruptcy law, collateral estoppel (issue preclusion) may bar re-litigation of the same cause of action if four elements exists:

1. The issue sought to be precluded must be the same as that involved in the prior action;
2. The issue must have been actually litigated;
3. It must have been determined by a valid and final judgment; and
4. The determination must have been essential to the final judgment.

Arizona's law of collateral estoppel has essentially the same elements. *Garcia v. Gen. Motors Corp.*, 195 Ariz. 510, 514 ¶ 9, 990 P.2d 1069, 1073 (App. 1999). *See, also, In re Berr,* 172 B.R. 209, 306 (9th Cir. BAP 1994). To determine this question, bankruptcy courts look to state law to ascertain if the state law cause of action contains the same elements as a § 523(a)(6) "wilful and malicious" cause of action. If they match, collateral estoppel bars re-litigation. If they do not match, then the bankruptcy cause of action must proceed to trial.

In this case, the Superior Court trial judge instructed the jury that a state law cause of action for intentional interference with a property right existed and, paraphrasing those instructions, it set forth the following elements:

1. The interference was substantial;

2. The interference was intentional, and was intended to cause an adverse result to the Nelsons; and

3. The interference was unreasonable under the circumstances.

In bankruptcy cases, a "wilful" injury must be "deliberate or intentional." *Geiger*, 523 U.S. at 61, FN 3. The wilful injury requirement of § 523(a)(6) "renders debt nondischargeable when there is either a subjective intent to harm, or a subjective belief that harm is substantially certain." *Carrillo v. Su (In re Su)*, 290 F.2d 1140, 1144 (9th Cir. 2002), *citing Petralia v. Jercich (In re Jercich)*, 238 F.2d 1202 (9th Cir. 2001).

The bankruptcy elements for "malicious" in a § 523(a)(6) action are:

1. a wrongful act,

2. done intentionally,

3. which necessarily causes injury, and

4. is done without just cause or excuse.

Jercich, 238 F.2d at 1209.

Comparing the two sets of elements leaves this court with the conclusion that collateral estoppel does not apply, and that the nondischargeability claim for this type of injury is not entitled to partial summary judgment in favor of Plaintiffs. There are other factual elements which need to be fleshed out at trial in bankruptcy court that did not exist in state court. Therefore, this issue must be tried, to ascertain whether Defendants' conduct rose to a nondischargeable debt for a "wilful and malicious injury."

RULING

The Defendants' motion for partial summary judgment on the $26,765 attorneys' fees claim is GRANTED, and that portion of the Nelsons' claim may be discharged. Plaintiffs' motion for partial summary judgment on this issue is DENIED.

Plaintiffs' motion for partial summary judgment on the $3,900 damage claim is DENIED. The Defendants' motion for summary judgment on the same issue is also DENIED. The matter must be tried, in order to determine if the $3,900 judgment is nondischargeable under § 523(a)(6).

The court will issue a separate interlocutory order on these issues.

The court sets **April 3, 2006, at 9:45 a.m.** in Courtroom 446, for a status conference to explore when the parties will be prepared to try the remaining § 523 (a)(6) and § 727 counts of Plaintiffs' complaint.

DATED: March 15, 2006.

JAMES M. MARLAR
UNITED STATES BANKRUPTCY JUDGE

COPIES served as indicated below this 15 day of March, 2006, upon:

Raymond R. Hayes
Bridegroom & Hayes
1656 N. Columbus Blvd.
Tucson, AZ 85712
Email bridegroomhayes@ultrasw.com

Scott M. Baker
Scott Macmillan Baker, PC
4562 N. First Ave., #100
Tucson, AZ 85718
Email smbaker1@qwest.net

Office of the United States Trustee
230 North First Avenue, Suite 204
Phoenix, AZ 85003-1706
U.S. Mail

By MB Thompson
Judicial Assistant

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B. The Jury Instructions and Interrogatories

1. Instructions

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   Answer: Yes.

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C. **Is the Judgment for Intentional Interference With a Property Right Dischargeable?**

To determine if a state court judgment is non-dischargeable in a bankruptcy case, the bankruptcy court must apply the doctrine of collateral estoppel. Here, the jury awarded damages of $3,900 for the Defendants' intentional interference with the Nelsons' property right.

Although principles of *res judicata* do not apply to dischargeability issues, *Brown v. Felsen,* 442 U.S. 127, 138-39, 99 S.Ct. 2205, 2212-13 (1979), principles of collateral estoppel do. *Brown, id., Grogan v. Garner,* 498 U.S. 279, 284, 111 S.Ct. 654 (1991).

Under bankruptcy law, collateral estoppel (issue preclusion) may bar re-litigation of the same cause of action if four elements exists:

1. The issue sought to be precluded must be the same as that involved in the prior action;
2. The issue must have been actually litigated;
3. It must have been determined by a valid and final judgment; and
4. The determination must have been essential to the final judgment.

Arizona's law of collateral estoppel has essentially the same elements. *Garcia v. Gen. Motors Corp.*, 195 Ariz. 510, 514 ¶ 9, 990 P.2d 1069, 1073 (App. 1999). *See, also, In re Berr,* 172 B.R. 209, 306 (9th Cir. BAP 1994). To determine this question, bankruptcy courts look to state law to ascertain if the state law cause of action contains the same elements as a § 523(a)(6) "wilful and malicious" cause of action. If they match, collateral estoppel bars re-litigation. If they do not match, then the bankruptcy cause of action must proceed to trial.

In this case, the Superior Court trial judge instructed the jury that a state law cause of action for intentional interference with a property right existed and, paraphrasing those instructions, it set forth the following elements:

1. The interference was substantial;

2. The interference was intentional, and was intended to cause an adverse result to the Nelsons; and

3. The interference was unreasonable under the circumstances.

In bankruptcy cases, a "wilful" injury must be "deliberate or intentional." *Geiger*, 523 U.S. at 61, FN 3. The wilful injury requirement of § 523(a)(6) "renders debt nondischargeable when there is either a subjective intent to harm, or a subjective belief that harm is substantially certain." *Carrillo v. Su (In re Su)*, 290 F.2d 1140, 1144 (9th Cir. 2002), *citing Petralia v. Jercich (In re Jercich)*, 238 F.2d 1202 (9th Cir. 2001).

The bankruptcy elements for "malicious" in a § 523(a)(6) action are:

1. a wrongful act,

2. done intentionally,

3. which necessarily causes injury, and

4. is done without just cause or excuse.

Jercich, 238 F.2d at 1209.

Comparing the two sets of elements leaves this court with the conclusion that collateral estoppel does not apply, and that the nondischargeability claim for this type of injury is not entitled to partial summary judgment in favor of Plaintiffs. There are other factual elements which need to be fleshed out at trial in bankruptcy court that did not exist in state court. Therefore, this issue must be tried, to ascertain whether Defendants' conduct rose to a nondischargeable debt for a "wilful and malicious injury."

RULING

The Defendants' motion for partial summary judgment on the $26,765 attorneys' fees claim is GRANTED, and that portion of the Nelsons' claim may be discharged. Plaintiffs' motion for partial summary judgment on this issue is DENIED.

Plaintiffs' motion for partial summary judgment on the $3,900 damage claim is DENIED. The Defendants' motion for summary judgment on the same issue is also DENIED. The matter must be tried, in order to determine if the $3,900 judgment is nondischargeable under § 523(a)(6).

The court will issue a separate interlocutory order on these issues.

The court sets **April 3, 2006, at 9:45 a.m.** in Courtroom 446, for a status conference to explore when the parties will be prepared to try the remaining § 523 (a)(6) and § 727 counts of Plaintiffs' complaint.

DATED: March 15, 2006.

JAMES M. MARLAR
UNITED STATES BANKRUPTCY JUDGE

COPIES served as indicated below this 15 day of March, 2006, upon:

Raymond R. Hayes
Bridegroom & Hayes
1656 N. Columbus Blvd.
Tucson, AZ 85712
Email bridegroomhayes@ultrasw.com

Scott M. Baker
Scott Macmillan Baker, PC
4562 N. First Ave., #100
Tucson, AZ 85718
Email smbaker1@qwest.net

Office of the United States Trustee
230 North First Avenue, Suite 204
Phoenix, AZ 85003-1706
U.S. Mail

By MB Thompson
Judicial Assistant